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S E C R E T SECTION 01 OF 02 KUWAIT 001381

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SUBJECT: TFIZ01: TRYING TO RESOLVE THE UNCC/RECONSTRUCTION
FUNDING CHALLENGE

REF: KUWAIT 1213

Classified By: Ambassador Richard H. Jones for reason 1.5 (D)

11. (C) SUMMARY: Decisions will be made soon about distributions of Iraqi oil revenues that may have significant political as well as economic ramifications. Our GOK contacts accept in principle the idea of reducing the percentage of Iraqi oil revenues paid into the UN Compensation Commission (UNCC) fund, but any attempt to change the mechanisms for adjudication and payment of claims, or a deep cut in the revenue flow, will alienate our Kuwaiti coalition partners. Therefore it is of vital importance that we work closely with the GOK as we develop our thinking. Moreover, it will be better for both of us if any new proposals are seen as Kuwaiti proposals. This message is intended to provide food for thought as Washington policy makers develop U.S. positions on these issues. It argues that a more stable flow of oil exports from Iraq will allow for cuts in the percentages for the Oil for Food program and the UN Compensation Committee without a concomitant fall in revenues for those programs, while at the same time providing sufficient funds for reconstruction and humanitarian needs. END SUMMARY.

12. (C) The GOK fully understands and supports the need to quickly rebuild Iraq, realizing that a prosperous and stable state on its Northern border is vital to its own prosperity and stability. However, GOK officials are also adamant that any new Iraqi government must fully comply with all UN Security Council resolutions. Thus, they are wary of any plan to drastically reduce UNCC payments in a way detrimental to adequate compensation for very real damages inflicted by Iraq's 1990-1991 invasion and occupation of Kuwait. Kuwait has been the USG's most indispensable partner in the fight against Saddam's regime, and therefore the USG should now work closely with the GOK to ensure its views are taken into account. Indeed, GOK officials have told us that they would like any proposals regarding changes in the distribution of Iraq's oil revenue to come from Kuwait. We believe that such a step would have important positive domestic, bilateral, and regional implications. Domestically the GOK will be able to demonstrate that it stood up for Kuwaiti rights; bilaterally, Kuwait can demonstrate its concern for Iraqi reconstruction; and regionally, the GOK will be able to say that it is not a passive bystander but an active architect of regional policy initiatives. All of these factors also serve U.S. interests.

LOOKING AT THE NUMBERS

13. (S/NF) The current formula divides revenues 72 percent to the Oil for Food (OFF) program, 25 percent for UNCC funds, and 3 percent for UNIKOM and other miscellaneous expenses. The problem is how to carve out funds for reconstruction from this mix without compromising UNCC payments. First, it should be noted that Iraq sold around 400,000 barrels of oil per day (bpd) to neighbors like Jordan and Syria at heavily discounted prices. Further, illicit oil trade (also over 400,000 bpd for most of the past years) can be expected to cease. Given relatively light damage to key Iraqi oil installations, this suggests an additional 800,000 bpd of oil and oil products will be available for export through the OFF program almost immediately. (One estimate we've seen is that restoring such trade at international market prices alone would have generated an extra \$1.1 billion in 2001 and an extra \$1.5 billion in 2002.)

14. (S/NF) Beyond restoring this illicit and discounted Iraqi oil to the revenue stream, we should recall that over the years Saddam continually manipulated the flow of Iraqi oil for his political purposes. Again, given the relatively light damage to Iraqi oil facilities, it is entirely possible that Iraq could relatively quickly return to its pre-invasion production capacity of 3.1 million barrels per day (mmbd). With an estimated 300,000 bpd consumed domestically, Iraq could have 2.8 mmbd of oil to sell at international prices.

15. (S/NF) 2.8 mmbd at a projected price of \$22.50 a barrel (assuming a likely fall in prices to historical averages after the end of the war) yields nearly \$23 billion a year. In 2002, according to numbers we've seen, Iraq sold about 2.0 mmbd at a similar price, which would have yielded total

revenue of just under \$16.5 billion. \$16.5 billion in 2002 divided according to the previous formula yields \$11.88 billion for OFF, \$4.125 billion for UNCC, and \$0.495 billion for UNIKOM/Misc. (Caveat: Note that these and all following figures are post estimates; even if the actual amounts differ slightly, the same principle should hold.) If the same formula is applied to our estimate of \$23 billion for post-war oil revenues, we could expect \$16.56 billion for OFF, \$5.75 billion for UNCC, and \$0.69 billion for UNIKOM/Misc.

6.(S/NF) However, if one assumes that the actual dollar contributions to OFF, UNCC and UNIKOM in 2002 were adequate to meet current needs for those programs, then the distribution formula could be altered significantly, and still leave enough revenues for their needs. For example (see table), on these assumptions, a distribution of 52 percent for OFF, 18 percent for UNCC and 2 percent for UNIKOM/Misc. should provide ample funding for these programs and still leave 28 percent (or over \$6.2 billion) for reconstruction.

	Current Distr. Formula (percent)	Current Revenue Distr. (\$bn)	New Distr. Formula (percent)	New Revenue Distr. (\$bn)
OFF	72	11.88	52	11.96
UNCC	25	4.125	18	4.14
UNIKOM	3	0.495	2	0.69
RECONSTRUCTION	0	0	28	6.21
Total Revenues	100	16.5	100	23.0

7.(C) As can be seen, Kuwait could actually propose a seven percentage point cut in the UNCC contribution and still expect to see a slight gain in UNCC revenues. More importantly, this formula allows 28 percent of Iraqi oil revenues to flow to reconstruction costs (\$6.21 billion). Although Iraq's long-term needs are enormous, we doubt that the country could absorb higher levels of reconstruction investment efficiently.

GENERATING MORE RECONSTRUCTION REVENUES

8.(C) One of the most important areas for early reconstruction and investment efforts must be agriculture. Iraq has a history of being a bread-basket for the region, but decades of mismanagement have devastated the sector. Reversing the damage caused by draining marshes, and rebuilding irrigation systems damaged by years of neglect, may take years, but early gains are possible. (One key step will be quickly resolving questions of land ownership.) Reviving agriculture will have many benefits, including providing jobs for the Iraqi people, but one of the most important will be reducing reliance on imported food and therefore freeing up OFF funds to be shifted to reconstruction.

DEBT RELIEF

9.(C) The Government of Kuwait has also expressed to us its support for a debt relief program, but with an important caveat; the program should concentrate on debts incurred during the period UN sanctions were in place. Their argument is that loans incurred during that period reduced the effects of sanctions and helped keep Saddam in power. We believe that such a debt relief proposal could be a useful complement to any package to change the UNCC contribution formulas. It could also be used as a foil to fend off any aggressive raids on the UNCC by the French, Germans, etc.

WHAT ELSE CAN WE DO

10.(C) Beyond generating funds for governmental reconstruction efforts, it is vital that the private sector is brought in to do its part. Reftel contained post suggestions on rapidly building trade and investment promotion plans to revive private sector interest in Iraq, a country we and the Kuwaitis have been locked out of for nearly 13 years. Beyond this, septel will suggest specific mechanisms to encourage Iraq's closest and wealthiest neighbors, the six states of the Gulf Cooperation Council, to play their part in the reconstruction effort.

JONES